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MD. SPECIAL REPORTS

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SUBCOMMITTEE REPORT

ON

INSURANCE COMPANY TAXATION

TO

THE MARYLAND TAX REVISION

COMMISSION OF 1939

December 3, 1940

Francis J. Carey, Chairman
Huntington Cairns
Oscar Leser
H. H. Walker Lewis

The recommendations in this report have been tentatively approved by the Commission. Comments and criticisms are requested.

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TO THE MARYLAND TAX REVISION COMMISSION OF 1939:

The Subcommittee on Corporation Taxation recommends that insurance company taxation in this State be simplified and inequalities therein be removed.

(a) By making the premiums tax apply to all new and renewal gross direct premiums allocable to this State, subject only to the deductions mentioned below. (Article 48A, Sections 39, 160).

Section 39 provides that "every insurance company (domestic or foreign) writing life, fire, marine, fidelity, surety, casualty, liability or compensation insurance, except domestic mutual fire insurance companies, shall pay annually to the Insurance Commissioner a tax on new and renewal gross direct premiums written in this State, but not on deposits received under annuity contracts issued in this State". It is provided, however, that nothing contained in the section is to "apply to premiums on policies covering weekly disability benefits and on which premiums are payable weekly". In addition, the tax is not paid on premiums on insurance written by credit indemnity companies, domestic title insurance companies, "non-profit hospital service plan" companies and fraternal beneficiary associations. (As to title insurance companies, see the subcommittee's report of October 7, 1940, pp. 15-17).

(b) By increasing the premiums tax rate in the case of life insurance writings to 2%, subject to the deductions mentioned below. (Sections 39, 160).

Section 39 provides that the tax shall be at the rate of 1-1/2% in the case of life insurance writings and 2% in the case of all other writings, subject to a credit for return premiums on cancelled policies.

The report form also provides for deduction of "dividends to policyholders by mutual companies other than life".

The following is an excerpt from the Report of the Special Committee on Insurance Taxation, Section of Insurance Law, American Bar Association, made in 1939:

The Association of Life Insurance Presidents, has determined that the average state premium tax, if computed on gross life insurance premiums without any deductions whatever, would be 1.8 per cent of such premiums annually. A report on net premiums written and taxes, licenses and fees paid by 26 stock casualty and surety companies compiled in 1938 by the Association of Casualty and Surety Executives shows that the state premium taxes for the stock companies were 2 per cent of premiums written and other state taxes (exclusive of taxes on real estate) added one-half of one per cent of premiums written. As to fire insurance companies, the premium tax rate in the majority of states for out-of-state companies is 2 per cent of taxable premiums, with some above and some below this rate. In a good many states domestic companies are not taxed at the same rate. Also a number of states impose an additional fire marshal tax on fire insurance premiums ranging from one-tenth of one per cent to three-fourths of one per cent and in several states additional fire department taxes are imposed on fire insurance premiums in cities having fire departments.

The cost of life insurance reflects the average State premiums tax paid by the companies, along with other costs. Maryland policyholders in life companies do not pay less for their insurance than policyholders in other states because Maryland imposes lower taxes on life companies than are imposed by other states. They pay just as much and the State loses the difference. The difference goes to carry insurance for policyholders outside the State. A tax of 2% on gross life insurance premiums with deduction of dividends permitted is nearly equal, in the average case, to a tax of 1.8% without deduction of dividends. If the tax on life insurance premiums were increased from 1.5%, the present rate, to 2% with deduction of dividends permitted, the State would gain

\$115,196.02 in revenue.* Only 1.7% of the insurance written by life companies doing business in Maryland is written in Maryland, so that only about 1.7% of this gain to the State, or \$1,958.33, would be reflected in the cost of life insurance in Maryland.

(c) By allowing the following deductions from gross direct premiums allocable to this State:

(i) Returned premiums on cancelled policies.

(ii) Dividends paid or credited to policyholders.

Dividends on life insurance policies which are applied to purchase additional insurance or shorten the premium paying period would not be deductible unless an equivalent amount was added to taxable premiums.

(iii) Other returns or refunds made or credited to policyholders, except for losses, including returns or refunds made or credited because of retrospective ratings and safe drive rewards. (Sections 39, 160).

Deduction of dividends paid or credited to policyholders is allowed to avoid discrimination against companies writing participating insurance. As explained above, the allowance of this deduction is taken into consideration in fixing the rate.

(d) By providing that new and renewal gross direct premiums, or portions thereof, derived from or reasonably attributable to insurance business in this State shall be allocated to this State. The allocation

* Letter of November 20, 1940, from John H. Coppage, Chief Examiner, State Insurance Department.

in what is now designated Schedule T of the Annual Statement approved by the National Convention of Insurance Commissioners would ordinarily be accepted when the method of allocation followed (to be fully described) results in an equitable allocation in substantial accord with the requirements of the law. (Sections 39, 160).

In general the effect of the change recommended will be to make the law conform to the present administration thereof.

(e) By imposing an annual tax on deposits made for perpetual policies of fire insurance.

Such deposits have not been taxed in the past. They should be taxed at a rate equivalent to the premiums tax. If it is assumed that $3\frac{1}{3}\%$ per annum is earned on such deposits, an annual tax thereon of $1/15$ of 1% would be the equivalent.

(f) By providing a uniform statewide annual company license fee of \$10. (Sections 34-38, 159, 178, 195, 236).

Such license fees now range from zero to \$1,500.

(g) By providing a uniform statewide annual company agent and company solicitor license fee of \$2. (Section 40).

The present fee is \$2 except for agents and solicitors of domestic companies for whom the fee is fifty cents. Fifty cents is too low.

(h) By imposing fees for valuing life insurance policies and annuity contracts only in cases in which a company whose home office is not in this State fails to furnish a proper certificate of valuation from

the insurance commissioner or proper official of some other State.

(Sections 40, 111).

(i) By providing that county and city taxation of insurance companies shall be limited to ordinary taxes on real estate, tangible personal property and shares in national banks and domestic corporations subject to ordinary taxes under Article 81. (Sections 160, 243).

(j) By exempting from the income tax net income of insurance companies derived from premiums, considerations for annuity contracts, interest, dividends and ground rents. Other rents, less related expenses, from real estate and tangible personal property in this State, plus the reasonable rental value, less related expenses, of real estate in this State owned and occupied by the company, would remain subject to the tax. (Section 223 (b) of Article 81 now completely exempts several classes of mutual insurance companies).

Funds invested in insurance should, in one way or another, bear a reasonable share of the tax burden. The policyholder is relieved of all taxes on such investments and the loss of revenue must be made good, to some extent at least, by taxing the insurance carriers. But it is almost universally agreed that a State net income tax on insurance companies, except as to income from real estate and tangible personal property, is not workable. "There are but four [states] which require income tax returns and payment of a tax from insurance companies. These are Maryland, Mississippi, Montana and South Dakota". (Report of the Special Committee on Insurance Taxation of the Section of Insurance Law, American Bar Association, 1939). Fear of retaliation by other states has doubtless played its part in the opposition of insurance companies to such laws, but there is a much sounder objection to them than that, particularly from

the State's point of view, namely, the difficulty of ascertaining the true net income of such companies. The problem arises out of the nature of the business and is particularly acute in the case of life insurance companies. (K. M. Williamson, Proceedings of the National Tax Association, 1934, p. 399, and authorities cited; see also Philip L. Gamble, Special Report No. 12, Taxation of Insurance Companies, State Tax Commission, New York, 1937, pp. 37-8).

(k) By repealing (i) the retaliatory provisions (Article 48A, Section 41) except as to States which have retaliatory laws applicable to insurance companies of this State and (ii) the reciprocal provisions (Sections 35, 159).

Much can be said in favor of complete repeal of the retaliatory, as well as the reciprocal, provisions. The subcommittee, however, is not recommending complete repeal at this time, but a partial repeal which it hopes will lead to similar action in other states and eventually to complete repeal.

A paper read at the Conference on Taxation held under the auspices of the National Tax Association in 1938 concludes as follows:

Little remains to be said with respect to the administrative aspects of retaliation and reciprocity. It is obvious that the necessity of administering the multiple tax laws brought into effect in such state under these practices imposes a heavy burden upon the insurance departments if they are to be carefully and faithfully administered. A former insurance commissioner has said, at any rate, that "the bases of taxation are so varied and complicated that hundreds of companies file incorrect returns not necessarily through bad faith, but on account of the fact that no human agency could ever interpret accurately some of the laws that varying legislatures have imposed upon the insurance companies." If the job of interpretation of the various laws is difficult for the companies, it must be equally arduous for the insurance commissioners. It is not a simple matter to administer a single tax law much less those of thirty or forty states.

Unless, therefore, adequate tax personnel is provided for the insurance departments, it would seem that, under retaliation, in many cases a near approach to self-assessment by the companies would be the result.

In conclusion, we have found that, whatever advantages retaliation and reciprocity may have in preventing excessive taxation of insurance companies, these practices have not only failed to remove the lack of uniformity in taxation, but have actually increased it. In addition, these systems have greatly enlarged the burden of tax administration. It would, thus, appear that the disadvantages of these devices outweigh their advantages and that a more promising approach to uniformity in state taxation of foreign insurance companies could be made through the avenue of administrative and legislative cooperation.

(K. M. Williamson, Reciprocity and Retaliation in Insurance Taxation, Proceedings of the National Tax Association, 1938, pp. 462, 479.)

At the same conference Mr. George B. Young, Vice-President, National Life Insurance Company, said:

The result is that almost every company in filing its returns in the various states has to compute the tax under the law where the tax return is being filed and under the law of its home state in order to determine under which law the tax has to be paid. This defeats uniformity and increases the expense to the companies. It seems to me that there has been no real benefit to the companies or to the states from these retaliatory acts. I believe that the states would be as well off and the companies much better off if the retaliatory and reciprocal statutes were done away with and a uniform state law could be adopted, making a uniform base for all of these premium taxes and if possible a uniform rate of taxation. This would accomplish all that these statutes were ever designed to accomplish, would yield as much revenue to the states and simplify the making of returns and the payment of taxes by the companies. It would greatly simplify the administrative duties of the commissioners, because then in each state they would simply have to determine the tax by their own law and not by other laws and they would not have to check every return to see which law gave the greater tax. A uniform state law giving a uniform base and a uniform rate would be the ideal method for taxing life insurance companies.

(Ibid., pp. 480, 484)

Annuity Contracts

The present exemption in Section 39 of "deposits received under annuity contracts issued in this State" was inserted by Chapter 225 of the Laws of 1937. They had theretofore been subject to the premiums tax (22 Op. Atty. Gen. 656). If the exemption is continued, it should not be confined to contracts "issued in this State".

Section 215(1) of Article 81 is as follows:

"Annuity income" means an amount equal to three per cent. (3%) per annum of the aggregate premiums or consideration paid for any annuity.

(Compare Section 22(b) (2) of the Internal Revenue Code). Annuity income as defined is included in "investment income" and is therefore subject to the 6% income tax. It has been suggested that this makes it unnecessary to tax the company on the consideration received for the contract. The subcommittee has not completed its study of the matter.

The subcommittee acknowledges the helpful assistance and courteous cooperation of Mr. John H. Coppage, Chief Examiner, State Insurance Department.

Francis J. Carey, Chairman

Huntington Cairns

Oscar Leser

H. H. Walker Lewis

December 3, 1940

The present exemption in Section 39 of "deposits received under annuity contracts issued in this State" was inserted by Chapter 225 of the laws of 1937. They had theretofore been subject to the premium tax (22 Op. Atty. Gen. 585). If the exemption is continued, it should not be confined to contracts "issued in this State".

Section 218(1) of Article 81 is as follows:

"Annuity income" means an amount equal to three per cent. (3%) per annum of the aggregate premiums or considerations paid for any annuity.

(Compare Section 22(b) (1) of the Internal Revenue Code). Annuity income as defined is included in "investment income" and is therefore subject to the 6% income tax. It has been suggested that this makes it unnecessary to tax the company on the consideration received for the contract. The subcommittee has not completed its study of the matter.

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December 5, 1940.